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SUBJECT: ALBANIA'S 2009 (ELECTORAL) BUDGET

SUMMARY

1. (SBU) PM Berisha declared that the 2009 budget, approved by Parliament on November 29, is an important instrument to finish his 2005 electoral promises, mainly the increase of salaries and pensions and the completion of several infrastructure projects. The opposition claims the budget is designed to win votes in the 2009 elections, ignores the global economic crisis and fails to provide adequate social protections for the poor. The budget supports a growth rate of six percent despite adverse global economic conditions, with an inflation rate between three and four percent. Total expenditures are USD 4.25 billion, and projects a budget deficit of 4.2 percent of GDP - slightly above the IMF's recommendation. Additional funds have been allocated for education and health programs as well as the continuation of the decentralization process. Spending for the defense sector will meet the NATO requirement of two percent of GDP. (Note: Please see Post's unclassified Intellipedia site http://www.intelink.gov/wiki/Albania_Economy_At_A_Glance for additional detail on the 2009 budget including comparisons to previous years.) End Summary

Growth with stability and security

2. (U) The 2009 budget, which will take effect January 1, continues to reap the benefits of tax reform and reduction of the informal sector. The budget helps boost business through lower taxes and streamlined administrative procedures, which could help shield the domestic economy from the global downturn. So far Albania has managed to keep the economy growing despite the recent global slowdown, mainly due to financial sector oversight and controls, and stronger than anticipated domestic demand. The GOA expects a real growth rate of six percent for 2009, higher than the four to five percent consensus among international financial institutions, with inflation remaining between two and four percent.

3. (U) The new budget forecasts total revenues to be USD 3.7 billion (all USD figures are based on an exchange rate of 90 lek to the dollar), or 28.2 percent of GDP. Revenues are expected to be higher than in 2008 in absolute terms, but will remain the same percentage of GDP. Revenue growth is mainly due to higher tax and customs revenues and payments from local governments, the result of further modernization of the fiscal system through tax reform and reduction of the informal sector. However, after three years of continuous fiscal stimulus through tax reductions, the government has decided to postpone a further reduction of the labor tax until May 2009 as recommended by the IMF.

4. (U) The IMF was pleased with the budget after the GOA reduced the budget deficit to 4.2 percent of GDP (from an original 4.5-5 percent) and delayed lowering the labor tax. The IMF has already reduced its estimate of Albania's GDP growth rate from 6 to 3.5 percent and has delivered a clear message that the Albanian economy is not an island and it will not remain fully insulated from the

global downturn, especially due to lower remittances and exports.

Higher budget, lower public investments

¶5. (U) At USD 4.25 billion, the 2009 budget, although Albania's highest in absolute terms, represents 32.5 percent of GDP, almost one percent less than the 2008 budget. Public investments of USD one billion are also lower than in 2008. The reduced capital spending will result in a lower budget deficit of 4.2 percent, something the IMF has been pushing to limit the negative effect of the global crisis.

¶6. (U) The Ministry of Transportation and Public Works will once again be the main recipient of public investment funds, with 63 percent of the total or USD 567 million. Almost all of it will be spent on road construction, with USD 333 million going toward the completion of the Durres-Kukes highway. Health and education remain two other priority sectors. The education sector will receive USD 467 million, or 3.6 percent of GDP, while the health sector will receive USD 366 million or 2.8 percent of GDP. However, in past years, neither of these sectors has been able to absorb the money allocated to it, resulting in further deterioration of the desperate conditions of schools and hospitals throughout Albania.

Budgeting for the crisis

¶7. (U) The global financial crisis has also affected Albania's budget by making it more difficult to borrow internationally. The GOA has postponed the issuance of USD 400 million in Eurobonds originally planned for 2009. The Eurobonds would have helped finance the Durres-Kukes road, but the GOA must now look to domestic

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financing schemes. The 2009 budget also includes the highest ever contingency reserve fund, USD 200 million, which will serve as a buffer against any crisis involving potential lack of cash and will ensure that salaries and pensions are paid.

Buying votes?

¶8. (SBU) The budget provides for significant increases in pensions and certain public sector salaries. PM Berisha considers the higher salaries (in some cases, twice what they were in 2005) as one of his key successes and the fulfillment of a 2005 campaign promise. The raises this year will become effective May 1, just one month before the elections, and will, according to Berisha, increase 2005 salaries by an average of 78 percent or USD 456 for 104,000 public administration employees. Certain categories, including elementary school teachers, nurses, and doctors, will see their paychecks doubled. 520,000 pensioners will receive higher pensions as of May 1 as well. Those in rural areas will on average double their retirement benefits compared to 2005 while other pensioners will see a 60 percent average increase. However, it is not clear where the salary increases will come from since the wage fund for 2009 is lower than in the 2008 budget.

¶9. (U) The opposition is concerned that the 2009 budget does not include any stimulation that could help protect the domestic economy from the global crisis. It also claims that the salary and pension increases do not match the recent increase of food, fuel and transport prices.

Comment

¶10. (U) It is much easier to win peoples' hearts and minds when you control what goes into their pockets. This budget is clearly designed to give the ruling Democratic Party an advantage this summer. However, there are many unknowns that could upset the DP's plans and cause their strategy to backfire. The biggest unknown is the effect of the global economic crisis, which could cause the government to default on payments for the Durres-Kukes road and possibly force a devaluation of the lek. Availability of electrical

energy could cause problems as well. While the reservoirs are filling due to heavy rains recently, if the rains stop, blackouts could be common again next spring. Finally, since the IMF program ends at the end of 2008, there will be no one to oversee the GOA's spending, which could exceed budgeted amounts in areas where votes are critical.